UNITED STATES
POSTAL REGULATORY COMMISSION
Washington, D.C. 20268-0001

FORM 10-Q

(Mark One)

☑ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED DECEMBER 31, 2013 OR**

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM __________ TO**

Commission File Number: N/A

UNITED STATES POSTAL SERVICE

(Exact name of registrant as specified in its charter)

Washington, D.C. (State or other jurisdiction of incorporation or organization)	41-0760000 (I.R.S. Employer Identification No.)
475 L'Enfant Plaza, S.W. Washington, D.C. (Address of principal executive offices)	20260 (ZIP Code)

(202) 268-2000
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☐ No ☐ Not Applicable ☑

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☐ No ☐ Not Applicable ☑

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐ Accelerated filer ☐

Non-accelerated filer ☐ (Do not check if a smaller reporting company) Smaller reporting company ☐

Not Applicable ☑

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☑
Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Stock	Outstanding Shares as of February 7, 2014
No Common Stock	N/A

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PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

United States Postal Service
Statements of Operations
(Unaudited)
(in millions)

	Three Months Ended December 31, 2013		Three Months Ended December 31, 2012	
Operating revenue	$	17,994	$	17,660
Operating expenses:				
Compensation and benefits		12,102		12,467
Retiree health benefits		2,153		2,078
Workers' compensation		-		324
Transportation		1,779		1,839
Other		2,272		2,172
Total operating expenses		18,306		18,880
Loss from operations		**(312)**		**(1,220)**
Interest and investment income		6		6
Interest expense		(48)		(50)
Net loss	**$**	**(354)**	**$**	**(1,264)**

See accompanying notes to the financial statements (unaudited).

United States Postal Service
Balance Sheets - Assets
(in millions)

	December 31, 2013 (Unaudited)	September 30, 2013 (Audited)
Current Assets		
Cash and cash equivalents	$ 3,754	$ 2,326
Restricted cash	272	312
Receivables:		
Foreign countries	683	618
U.S. government	64	118
Other	325	302
Receivables before allowances	1,072	1,038
Less allowances	55	54
Total receivables, net	1,017	984
Supplies, advances and prepayments	175	122
Total Current Assets	**5,218**	**3,744**
Noncurrent Assets		
Property and equipment, at cost:		
Buildings	24,496	24,452
Equipment	19,692	19,629
Land	2,891	2,895
Leasehold improvements	1,307	1,290
	48,386	48,266
Less allowances for depreciation and amortization	31,531	31,156
	16,855	17,110
Construction in progress	366	402
Total property and equipment, net	17,221	17,512
Other assets - principally revenue forgone receivable	403	385
Total Noncurrent Assets	**17,624**	**17,897**
Total Assets	**$ 22,842**	**$ 21,641**

See accompanying notes to the financial statements (unaudited).

United States Postal Service
Balance Sheets - Liabilities and Net Deficiency
(in millions)

	December 31, 2013 (Unaudited)	September 30, 2013 (Audited)
Current Liabilities		
Compensation and benefits	$ 2,848	$ 1,529
Retiree health benefits	18,139	16,766
Workers' compensation	1,391	1,322
Payables and accrued expenses:		
Trade payables and accrued expenses	1,274	1,237
Foreign countries	605	564
U.S. government	114	112
Total payables and accrued expenses	1,993	1,913
Deferred revenue-prepaid postage	3,182	2,993
Customer deposit accounts	1,228	1,229
Outstanding postal money orders	621	671
Prepaid box rent and other deferred revenue	443	460
Short-term portion of debt	9,800	9,800
Total Current Liabilities	**39,645**	**36,683**
Noncurrent Liabilities		
Workers' compensation costs	14,511	15,918
Employees' accumulated leave	2,020	1,982
Deferred appropriation and other revenue	167	159
Long-term portion capital lease obligations	338	354
Deferred gains on sales of property	303	308
Contingent liabilities and other	835	860
Long-term portion of debt	5,200	5,200
Total Noncurrent Liabilities	**23,374**	**24,781**
Total Liabilities	**63,019**	**61,464**
Net Deficiency		
Capital contributions of the U.S. government	3,132	3,132
Deficit since 1971 reorganization	(43,309)	(42,955)
Total Net Deficiency	**(40,177)**	**(39,823)**
Total Liabilities and Net Deficiency	$ **22,842**	$ **21,641**

See accompanying notes to the financial statements (unaudited).

United States Postal Service
Changes in Net Deficiency
(Unaudited)
(in millions)

	Capital Contributions of U.S. Government		Deficit Since Reorganization		Total Net Deficiency	
Balance, September 30, 2012	$	3,132	$	(37,978)	$	(34,846)
Net loss		-		(1,264)		(1,264)
Balance, December 31, 2012	**$**	**3,132**	**$**	**(39,242)**	**$**	**(36,110)**
Balance, September 30, 2013	$	3,132	$	(42,955)	$	(39,823)
Net loss		-		(354)		(354)
Balance, December 31, 2013	**$**	**3,132**	**$**	**(43,309)**	**$**	**(40,177)**

See accompanying notes to the financial statements (unaudited).

United States Postal Service
Statements of Cash Flows
(Unaudited)
(in millions)

	Three Months Ended December 31, 2013	Three Months Ended December 31, 2012
Cash flows from operating activities:		
Net loss	$ (354)	$ (1,264)
Adjustments to reconcile net loss to cash provided by operations:		
Depreciation and amortization	463	483
(Gain) loss on disposals of property and equipment, net	(29)	3
(Decrease) increase in other assets - primarily appropriations receivable revenue forgone	(18)	5
Decrease in noncurrent workers' compensation liability	(1,407)	(1,034)
Increase in noncurrent employees' accumulated leave	38	18
Increase in noncurrent deferred appropriations and other revenue	20	13
(Decrease) increase in other noncurrent liabilities	(25)	1
Changes in current assets and liabilities:		
Receivables, net	(33)	(8)
Supplies, advances and prepayments	(53)	(47)
Compensation and benefits	1,319	1,043
Retiree health benefits	1,373	1,427
Workers' compensation	69	4
Payables and accrued expenses	79	(81)
Customer deposit accounts	(1)	49
Deferred revenue-prepaid postage	189	212
Outstanding postal money orders	(50)	(36)
Prepaid box rent and other deferred revenue	(16)	(31)
Net cash provided by operating activities	1,564	757
Cash flows from investing activities:		
Change in restricted cash requirements	40	(69)
Purchases of property and equipment	(182)	(166)
Proceeds from sales of property and equipment	32	29
Net cash used in investing activities	(110)	(206)
Cash flows from financing activities:		
Issuance of notes payable	2,700	2,700
Payments on notes payable	(2,700)	(2,700)
Payments on capital lease obligations	(14)	(15)
U.S. government appropriations - expensed	(12)	(12)
Net cash used in financing activities	(26)	(27)
Net increase in cash and cash equivalents	1,428	524
Cash and cash equivalents at beginning of year	2,326	2,087
Cash and cash equivalents at end of period	**$ 3,754**	**$ 2,611**
Supplemental cash flow disclosures:		
Cash paid for interest	$ 49	$ 50

See accompanying notes to the financial statements (unaudited).

Notes to Financial Statements (Unaudited)

Note 1 – Basis of Presentation

The accompanying unaudited financial statements have been prepared in accordance with United States (U.S.) generally accepted accounting principles (GAAP) for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of the U.S. Securities and Exchange Commission (SEC) Regulation S-X. All material adjustments, including normal recurring adjustments, necessary for a fair presentation have been included. Where necessary, disclosure is made in the report for all other adjustments. Certain notes and other information normally included in the financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to instructions, rules and regulations prescribed by the SEC. Except as otherwise specified, all references to years are to the fiscal year beginning October 1 and ending September 30 and quarters are quarters within fiscal years 2014 and 2013.

In the opinion of management, the accompanying unaudited interim financial statements reflect all adjustments necessary to fairly present the financial position as of December 31, 2013, and the results of operations and cash flows for the three months ended December 31, 2013 and 2012. Operating results for the three month period ended December 31, 2013, are not necessarily indicative of the results that may be expected for all of fiscal year 2014. Subsequent events have been evaluated through February 7, 2014, the date the Postal Service filed its Form 10-Q for the quarter ended December 31, 2013, with the Postal Regulatory Commission (PRC).

The Postal Service has significant transactions with other U.S. Government agencies, as disclosed throughout this report. In addition to the amounts disclosed elsewhere, deferred revenue of $23 million at December 31, 2013, and $37 million at September 30, 2013, related to government deposits are included in the Balance Sheets in "Customer deposit accounts."

These financial statements should be read in conjunction with the Postal Service's financial statements for the year ended September 30, 2013 filed as part of the Postal Service's Annual Report on Form 10-K as filed with the PRC on November 15, 2013.

Note 2 – Liquidity
LIQUIDITY CONCERNS

The Postal Service continues to suffer from a lack of liquidity. The Postal Service held unrestricted cash of $3.8 billion and $2.3 billion as of December 31, and September 30, 2013, respectively, and had no remaining borrowing capacity on its $15 billion debt facility (See *Note 3, Debt*, for additional information). The increase in cash balances for the quarter is largely attributable to the seasonal impact of holiday mailings and timing differences related to the payment of liabilities. The current positive cash balance exists only due to defaults on $16.7 billion of the legally-mandated prefunding payments due to the Postal Service Retiree Health Benefits Fund (PSRHBF) in 2012 and 2013. Additionally, the Postal Service anticipates that it will be unable to make its next $5.7 billion payment due by September 30, 2014, and it has no ability to borrow additional funds. As of the date of this report, February 7, 2014, the Postal Service has incurred no penalties or negative consequences resulting from its inability to make these payments. The Postal Service does not have sufficient liquidity to make meaningful reductions in its debt and important investments in its infrastructure. Further, this level of cash could be insufficient to support operations in the event of another significant downturn in the U.S. economy.

The Postal Service incurred a net loss of $354 million for the first quarter of the year, which includes $1.4 billion of expense accrued for the legally-mandated prefunding payment for retiree health benefits. The requirement of the *Postal Accountability and Enhancement Act*, Public Law 109-435 (P.L. 109-435) to prefund its retiree health benefit obligations, a requirement not shared by other federal agencies or private sector businesses, the ongoing decline in First-Class mail volume caused by changes in consumers' and businesses uses of mail resulting from the Great Recession and the continuing migration toward electronic communication and transactional alternatives have been major factors contributing to Postal Service losses. Without structural change to the Postal Service's business model, it will continue to be negatively impacted by these factors and, absent legislative change, it anticipates continuing quarterly losses for the remainder of 2014.

The Postal Service was able to make its annual payment of approximately $1.4 billion to reimburse the Department of Labor (DOL) for workers' compensation expenses in October 2013. However, current projections indicate that the Postal Service will continue to have a low level of liquidity throughout 2014. Absent legislative action to assist the Postal Service in returning to a financially stable position, this low level of liquidity will continue to exist.

In the event that circumstances leave the Postal Service with insufficient cash, the Postal Service would be required to implement contingency plans to ensure that mail deliveries continue. These measures could require the Postal Service to prioritize payments to its employees and suppliers ahead of some payments to the Federal Government, as has been done in the past. Additionally, the Postal Service continues to seek a refund of the overfunding of Federal Employees' Retirement System (FERS) as those funds would help alleviate some of the Postal Service's short-term liquidity risks. The latest available information from the Office of Personnel Management (OPM) estimates that the FERS overfunding was $500 million at September 30, 2013. The Office of the Inspector General has determined that if Postal Service specific assumptions were used to estimate the FERS obligation, rather than the government-wide averages currently used, the surplus would be significantly greater than the amount calculated by OPM.

POSTAL ACTIONS TAKEN TO IMPROVE LIQUIDITY

In 2013, the Postal Service's Board of Governors directed management to accelerate the realignment of Postal Service operations to further reduce costs in order to strengthen its finances, citing the fact that the Postal Service cannot wait indefinitely for legislation. Additionally, the Postal Service has leveraged employee attrition from the Voluntary Early Retirement (VER) and increased utilization of non-career employees, as provided by the new labor agreements, which allowed for better alignment of staffing and workload levels, resulting in reduced labor costs.

In February 2013, the Postal Service announced plans to transition to a new delivery schedule which would include package delivery Monday through Saturday and mail delivery Monday through Friday; however it was unable to implement these plans due to legislative constraints. The transition to a more cost-effective delivery schedule remains one of the most significant savings opportunities available to the Postal Service and remains a part of its *2013 Five-Year Business Plan* (Business Plan). The Postal Service continues to request comprehensive legislation that will enable changes to the business model and allow a transition to a new delivery schedule and remains hopeful that future legislation will change the 6-day delivery requirement.

In April 2013, the Postal Service released its updated comprehensive Business Plan which details the implementation of its targeted program to eliminate nearly $20 billion of annual cost from the business by the year 2017. This plan continues the Postal Service's efforts to aggressively pursue the strategies within its control to increase operational efficiency and to improve its liquidity position. The Business Plan requires a combination of operational realignment, aggressive cost reductions, and comprehensive legislation to reform the Postal Service's current business model. Several key provisions included in the Business Plan, in addition to the modified delivery schedule, are outlined below:

- Alignment of network size and cost to manage reduced mail volumes;
- Revenue management to introduce new service offerings to generate new revenue and slow the migration of existing revenue streams to electronic alternatives;
- Implementation of a new healthcare program and integration of this plan with Medicare to provide postal employees and retirees with actuarially equivalent benefits at a lower cost;
- Changes to the Postal Service's business and governance model will assist the Postal Service in returning to a position of financial viability in the long run.

In September 2013, the Postal Service requested and the PRC subsequently approved price increases on Market-Dominant and Competitive products. The Market-Dominant increases include a 1.7% price increase based on the consumer price index plus a 4.3% increase approved by the PRC in December 2013 as a temporary exigent rate change. The exigent change is approved as a surcharge to be collected only until the Postal Service recovers $3.2 billion of incremental revenue above what it would otherwise have recovered through a CPI increase alone. The Postal Service is appealing the temporary nature of this change. Additionally, prices increased an average of 2.4% for Competitive products. These Market-Dominant and Competitive products changes went into effect on January 26, 2014 and are expected to generate approximately $2.7 billion of additional annualized revenue for the Postal Service.

MITIGATING CIRCUMSTANCES

The Postal Service's status as an independent establishment of the executive branch that does not receive tax dollars for its operations presents unique requirements and restrictions, but also potentially mitigates some of the financial risk that would otherwise be associated with a cash shortfall. With revenue in excess of $67 billion, generated almost entirely through the sale of postage and delivery services, a financially sound Postal Service is vital to American commerce. The U.S. economy benefits greatly from the Postal Service and the many businesses that provide the printing and mailing services that support it. Disruption of the mail would cause undue hardship to businesses and consumers. Therefore, it is unlikely that, in the event of a cash shortfall, the Federal Government would allow the Postal Service to significantly curtail or cease operations.

The Postal Service continues to inform the Administration, Congress, the PRC, and other stakeholders of the immediate and longer-term financial challenges it faces and the legislative changes that would help restore financial stability. The Postal Service will continue to pursue legislative changes, cost reductions, and additional ways to generate revenues in 2014. Many of the structural reforms needed to ensure long-term viability, such as adjustments to the retiree health benefit pre-funding payment schedule and changes to delivery standards, can only be achieved with legislative change. Given the vital role the Postal Service plays in the U.S. economy, it is hopeful that legislation will be enacted which will mitigate the Postal Service's short-term financial challenges and provide it with the authority to make needed changes to ensure long-term financial stability. However, there can be no assurances that the requests to restructure the PSRHBF prefunding payment schedule, or any other legislative changes, will be made in time to impact 2014, or at all.

Note 3 – Debt

The Postal Service's debt consists of various fixed- and floating-rate notes with various maturities and an aggregate principal balance of $15 billion as of December 31 and September 30, 2013. All debt is borrowed from the Federal Financing Bank (FFB), a government-owned corporation under the general supervision of the Secretary of the Treasury. The current portion of the principal balance, due within one year, is $9.8 billion and is classified as a current liability. The remaining $5.2 billion is classified as a noncurrent liability. The interest rates on the individual notes range from 0.125% to 3.790% with maturities ranging from less than one month to 25 years. As of December 31, 2013, the premium associated with the prepayment of all debt is $185 million based upon current prevailing interest rates.

Included in short-term debt are two revolving credit line facilities, renewable annually, with the FFB, both of which are available until April 2014. These short-term credit lines enable the Postal Service to draw up to $4 billion. The interest rates for borrowings under these credit facilities are determined by the Treasury each business day. As of December 31, 2013 and 2012, these two revolving credit facilities were fully drawn.

The Postal Service's credit facilities and note arrangements provide the flexibility to borrow short- or long-term, using fixed- or floating rate notes. However, the Postal Service is limited by statute to net annual debt increases of $3 billion, and total debt cannot exceed $15 billion. For 2014, the amount of borrowing is constrained by the total debt ceiling limitation of $15 billion, which the Postal Service reached during fiscal year 2012.

Note 4 – Property and Equipment

Property and equipment are recorded at cost, less allowances for depreciation and amortization, which includes the interest on borrowings used to pay for the construction of major capital additions. Interest capitalized during the three month periods ended December 31, 2013, and 2012, was not material. Property and equipment are depreciated over estimated useful lives that range from 3 to 40 years, except for buildings with historic status, which are depreciated over 75 years, using the straight-line method.

Assets classified as held for sale of $57 million as of December 31, 2013, and $78 million as of September 30, 2013, are included on the Balance Sheets in "Land" and "Buildings." Impairment charges were not material for the three month periods ended December 31, 2013 and 2012.

Deferred gains on sales of property are recognized in income and the sold assets removed from the accounting records when any lease-backs or other conditions requiring continued Postal Service involvement in the properties have expired. Deferred gains recognized in income were not material for the three months ended December 31, 2013, and 2012, respectively.

Note 5 – Leases and Other Commitments
Leases

Future minimum payments for all non-cancelable leases as of December 31, 2013, were as follows:

Lease Obligations (Dollars in millions)	Operating	Capital
(Unaudited)		
2014	$ 559	$ 69
2015	687	91
2016	619	87
2017	551	79
2018	500	64
Thereafter	3,773	150
Total lease obligations	**$ 6,689**	**$ 540**
Less interest		144
Total capital lease obligations		**396**
Less current portion of capital lease obligations		58
Noncurrent portion of capital lease obligations		**$ 338**

The current portion of the capital lease obligation is included in "Trade payables and accrued expenses" on the Balance Sheets.

Rent expense consisting of non-cancelable real estate leases, facilities leased from the Government Service Administration and other equipment and short-term rentals for the three month periods ended December 31, 2013, and 2012, was $283 million and $279 million, respectively.

Capital

Capital commitments consist primarily of equipment and building construction and improvements. At December 31, 2013, commitments to acquire capital assets were $549 million, compared to **$**708 million at September 30, 2013, a decrease of $159 million. Financial commitments for approved capital projects in progress were as follows:

Capital Commitments (Dollars in millions)	As of December 31, 2013	September 30, 2013
	(Unaudited)	
Mail processing equipment	$ 286	$ 316
Building improvements, construction, and building purchases	185	329
Postal support equipment	71	50
Vehicles	7	13
Total capital commitments	**$ 549**	**$ 708**

Note 6 – Contingent Liabilities

Contingent liabilities consist primarily of claims and lawsuits resulting from labor, employment, and environmental matters, property damage claims, injuries on postal properties, issues arising from postal contracts, personal claims, and traffic accidents.

Each quarter, significant new claims and litigation are evaluated for the probability of an adverse outcome. If the claim is deemed probable of an unfavorable outcome and the amount of the potential resolution is reasonably estimable, a liability for the loss is recorded. Each quarter, any pre-existing claims and litigation are reviewed and adjusted for resolutions or revisions to prior estimates. This evaluation of cases resulted in an increase of $43 million to the liability for the three months ended December 31, 2013.

The following table summarizes contingent liabilities provided for in the Postal Service's financial statements as of the dates indicated.

Contingent Liabilities (Dollars in millions)	As of December 31, 2013 (Unaudited)	As of September 30, 2013
Labor - employment	$ 849	$ 809
Environmental	48	48
Tort	52	49
Contractual	33	33
Total contingent liabilities	$ 982	$ 939

Based upon currently available information, adequate provision has been made for probable losses arising from claims and suits. The current portion of this liability of $176 million and $108 million as of December 31, 2013 and September 30, 2013, respectively, is included on the Balance Sheets in "Trade payables and accrued expenses." The long-term portion of this liability of $806 million and $831 million as of December 31, 2013 and September 30, 2013, respectively, is included on the Balance Sheets in "Contingent liabilities and other."

In addition to the amounts accrued in the financial statements, the Postal Service also has claims and lawsuits which it deems reasonably possible of an unfavorable outcome which range from $275 million to $875 million at December 31, 2013. At September 30, 2013, the range was $325 million to $925 million. No provisions for these reasonably possible losses are accrued or included in the financial statements.

Note 7 – Retirement Programs

Employees participate in one of three Federal Government pension programs based on the starting date of their employment with the Federal Government. Employee and employer contributions are made to the Civil Service Retirement System (CSRS), the Dual Civil Service Retirement System/Social Security (Dual CSRS), or the FERS, all of which are administered by the OPM. As government-sponsored benefit plans, the CSRS, Dual CSRS and FERS are not subject to the provisions of the *Employee Retirement Income Security Act of 1974*, as amended. Employees may also participate in the Thrift Savings Plan (TSP), a defined contribution retirement savings and investment plan, administered by the Federal Retirement Thrift Investment Board. The Postal Service cannot direct the costs, benefits, or funding requirements of the plans. Accordingly, the Postal Service's participation in the Federal retirement plans is accounted for using multiemployer plan accounting rules.

Retirement expense was $1,462 million and $1,481 million for the three months ended December 31, 2013, and 2012, respectively. Retirement expense is recorded in "Compensation and benefits" in the Statements of Operations, and includes the costs of FERS, TSP and employers' share of Social Security taxes.

EMPLOYEE/EMPLOYER CONTRIBUTIONS

P.L. 109-435 suspended the employer contributions to CSRS that would otherwise have been required under Title 5, Section 8334(a)(1) of the United States Code until 2017. At that time, OPM will determine whether additional funding is required for the benefit of postal CSRS retirees. As a result, the Postal Service contribution rate for CSRS and Dual CSRS was zero in 2013 and 2012.

As required by law, the Postal Service contribution rate was 11.9% of base salary for most current FERS employees for the three months ended December 31, 2013, and 2012. The Postal Service is required to contribute a minimum of 1% per year of the basic pay, and to match a voluntary employee contribution up to 3% of the employee's basic pay, and 50% of an employee's contribution of between 3% and 5% of basic pay to the TSP of FERS employees.

Note 8 – Health Benefit Plans
CURRENT EMPLOYEES

Substantially all career employees are covered by the Federal Employees' Health Benefits Program (FEHBP). This plan covers both active and retired employees. Health care benefits are available to all participants who meet certain eligibility requirements. In addition to administering the program, OPM allocates the cost of FEHBP to the various participating government agency employers. The Postal Service cannot direct the costs, benefits, or funding requirements of the plan and, therefore, accounts for program expenses using multiemployer plan accounting rules. Contributions to the plan are recorded as an expense in the period in which the contribution is due. The portion of the premium cost paid by the Postal Service for most active employees is determined through agreements with its unions.

Employees paid approximately 23% and 22% of the premium costs in the three months ended December 31, 2013, and 2012, respectively. Postal Service employee healthcare expense was $1,222 million, and $1,286 million in the three months ended December 31, 2013, and 2012, respectively. These expenses are included in "Compensation and benefits" in the Statement of Operations.

RETIREES

Employees who participate in the FEHBP for the five years immediately preceding their retirement may participate in the FEHBP during their retirement. The Postal Service is required to pay the employer's share of health insurance premiums for all retired postal employees and their survivors who participate in the FEHBP and who retire on or after July 1, 1971. The employer's share of premium costs for retirees (and their survivors) is set by law and is not subject to negotiation with the unions. Costs attributable to federal civil service before July 1, 1971, are not paid by the Postal Service.

The Postal Service is required to prefund retiree health benefits beginning in 2007, by depositing funds into the PSRHBF each year through 2016. No other agency that participates in FEHBP, nor the vast majority of commercial companies, are required to prefund retiree health benefits for their employees. The Postal Service has recorded $18.1 billion as a current liability for the PSRHBF prefunding requirements on its December 31, 2013 Balance Sheet. This includes payment defaults of $11.1 billion in 2012 and $5.6 billion in 2013, and $1.4 billion accrued for the 2014 payment of $5.7 billion due by September 30, 2014.

Current law also obligates the Postal Service to make additional payments of $5.7 billion in 2014, $5.7 billion in 2015, and $5.8 billion in 2016, due by September 30 of each respective year. Although P.L. 109-435 dictates the annual prefunding requirements through 2016, these amounts and the timing of funding could be changed at any time with enactment of a new law or an amendment of existing law. To date, no law changes have addressed these required payments. However, given its low levels of liquidity, the Postal Service will likely be forced to default on these prepayments in order to ensure that it continues to be able to fulfill its other statutory obligations, including the obligation to provide universal mail service to the nation (as discussed in *Note 2, Liquidity*). P.L. 109-435, the statutory requirement establishing the payment schedule, contains no provisions addressing a payment default.

At December 31, 2013, scheduled prefunding payments to the PSRHBF are:

PSRHBF Commitment (Dollars in millions)	**P.L. 109-435 Requirement**
2014 *	**$ 22,400**
2015	**5,700**
2016	**5,800**
Thereafter	**-**
Total PSRHBF commitment	**$ 33,900**

* This amount includes defaults on $16.7 billion due to the PSRHBF as of September 30, 2013 and $5.7 billion due by September 30, 2014. Amortization of the unfunded liability at September 30, 2016 is not reflected above.

These annual prefunding payments are in addition to the regularly allocated cost of premiums for current retirees, which continue to be payable through 2016. The law requires that, not later than 2017, OPM will perform an actuarial valuation to determine if additional payments into the PSRHBF are required. If required, OPM will design an amortization schedule to fully fund any remaining liability by 2056. Starting in 2017, the Postal Service's share of the health insurance premiums for current and future Postal

Service retirees will be paid from the PSRHBF. Also, beginning in 2017, the Postal Service will fund the actuarially determined normal cost attributable to that year's service for employees who will retire in the future.

Retiree Health Benefits	Three Months Ended December 31,	
(Dollars in millions)	2013	2012
(Unaudited)		
Employer premium expense	$ 728	$ 678
Accrual for P.L. 109-435 payment to PSRHBF	1,425	1,400
Total retiree health benefits expense	$ 2,153	$ 2,078

Total retiree health benefits expense was $2,153 million, and $2,078 million for the three months ended December 31, 2013, and 2012, respectively. These costs, which are reflected as "Retiree health benefits" in the Statement of Operations, consist of payments to OPM for the Postal Service's share of FEHBP retiree premiums currently being paid, plus accrued prefunding payments to the PSRHBF for current employees who will retire in the future.

The Postal Service recognized $1,425 million and $1,400 million of PSRHBF expense for the three months ended December 31, 2013, and 2012, respectively. Because the amounts to be paid into the PSRHBF are set by legislation, the Postal Service retiree health expense may represent more or less than the full cost of the benefits earned by Postal Service employees.

Note 9 – Workers' Compensation

Postal employees injured on the job are covered by the Federal Employees' Compensation Act (FECA), administered by the DOL Office of Workers' Compensation Programs (OWCP), which makes all decisions regarding injured workers' eligibility for benefits. However, the Postal Service annually reimburses the DOL for all workers' compensation benefits paid to or on behalf of employees, and pays an administrative fee to the DOL.

An estimation model that combines four generally accepted actuarial valuation techniques is used to project future claim payments based upon past claim-payment experience and exposure to claims as measured by total hours worked by Postal Service employees. Open claims and past claim payment experience are data inputs to the model that are supplied by the DOL. The data required to update the model for the quarter ended December 31, 2013 was not received from DOL in a timely manner. Therefore, the Postal Service has estimated the workers' compensation liability using the model's projected claims for the current period based upon actual data from the periods ending on or prior to June 30, 2013.

A liability is recorded for the present value of estimated future payments to postal employees, or their qualified survivors, who have been injured through the end of the reporting period. The estimated total cost of a claim is based on the date of the injury, pattern of historical payments, frequency or severity of the claim-related injury or injuries, and the expected trend in future costs. The Postal Service uses the average rate of medical inflation experienced by its workers' compensation claimants over the past five years as an estimate for future medical inflation. The liability for claims arising more than ten years ago is determined by an independent actuary.

The FECA benefit structure is often superior to benefits available under normal federal retirement, and these more lucrative payments will, in some cases, be for the rest of the claimants' lives which may cause an undue financial burden on the Postal Service.

The liability for estimated future workers' compensation payments is recorded at its present value. To record the liability and annual expense, an estimate is made of the amount of funding that would need to be invested at current interest rates in order to fully fund all estimated future payments. Inflation and discount (interest) rates are updated as of the date of the financial statements to determine the present value of the workers' compensation liability at fair value in accordance with GAAP. The impact of changes in the discount and inflation rates is accounted for as a change in accounting estimate and included in operating expenses.

The estimation of the liability is highly sensitive to changes in inflation and discount rates. An increase of 1% in the discount rate would decrease the liability and expense by approximately $1.6 billion as of December 31, 2013. A decrease of 1% in the discount rate would increase the liability and expense by approximately $2.0 billion as of December 31, 2013.

The inflation and discount rates used to estimate the workers' compensation liability and related expense are shown in the following table:

Workers' Compensation Liability Inflation and Discount Rates	Quarter Ended December 31, 2013	September 30, 2013	December 31, 2012	September 30, 2012
(Unaudited)				
Compensation claims liability:				
Discount rate	**3.3%**	**3.0%**	**2.3%**	**2.1%**
Wage inflation	**2.9%**	**2.9%**	**2.9%**	**2.9%**
Medical claims liability:				
Discount rate	**3.3%**	**3.0%**	**2.3%**	**2.2%**
Medical inflation	**9.1%**	**9.1%**	**8.9%**	**8.9%**

The present value of the liability for future workers' compensation payments was $15,902 million and $17,248 million as of December 31, 2013 and September 30, 2013, respectively. On October 15, 2013, the Postal Service made the scheduled annual payment to the DOL of $1,372 million, which included $50 million of prepaid administrative fees. As of December 31, 2013 and September 30, 2013, the current portion of the liability was $1,391 million and $1,322 million, respectively.

Changes in the workers' compensation liability are attributable to the combined impact of changes in the discount and inflation rates, routine changes in actuarial estimation, new compensation and medical cases, and the progression of existing cases. Workers' compensation expense, including the impact of changes in the discount rates, for the three month periods ended December 31, 2013, and 2012, was as follows:

Workers' Compensation Expense (Dollars in millions)	Three Months Ended December 31, 2013	2012
(Unaudited)		
Impact of discount rate changes	**$ (541)**	**$ (226)**
Actuarial valuation of new cases and revaluation of existing cases	**524**	**533**
Subtotal	**(17)**	**307**
Administrative fee	**17**	**17**
Total workers' compensation expense	**$ -**	**$ 324**

Note 10 – Fair Value Measurements

The Postal Service estimates that the carrying value of current assets and liabilities approximates fair values. The Postal Service also has non-current financial instruments, such as the long-term portion of debt (see *Note 3-Debt*) and long-term receivables (see *Note 11-Revenue Forgone*), that must be measured for disclosure purposes on a recurring basis following authoritative accounting literature in GAAP. The Postal Service also applies these requirements to various non-recurring measurements of financial and non-financial assets and liabilities, such as the impairment of property and equipment. Measurement of assets and liabilities at fair value is performed using inputs from the following three levels of the fair value hierarchy as defined in the authoritative literature:

- Level 1 inputs include unadjusted quoted prices in active markets for identical assets or liabilities as of the balance sheet date.
- Level 2 inputs include quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets or liabilities in inactive markets, observable data, other than quoted market prices, for the asset or liability (i.e., interest rates, yield curves, etc.) and inputs that are derived from, or corroborated by, observable market data.
- Level 3 inputs include unobservable data that reflect current assumptions about the judgments and estimates that market participants would use when pricing the asset or liability. These inputs are based on the best information available, including internal data.

Because no active market exists for the debt with the FFB, the fair value of the noncurrent portion of these notes has been estimated using prices provided by the FFB, a Level 3 input.

The fair value of revenue forgone has been estimated using the income method and discount rates on similar assets, such as noncurrent U.S. Treasury securities that have a similar maturity, a level 2 input.

The carrying values of current assets and liabilities approximate their fair values due to the short-term maturity of those financial instruments. The carrying values and the fair values of noncurrent assets and liabilities that qualify as financial instruments in accordance with the accounting literature are as indicated in the table below. This table is presented for disclosure purposes only. The Postal Service has not recorded a gain or loss to its operations for the differences between carrying and fair values of the above assets and liabilities.

Fair Value of Long-Term Financial Assets and Liabilities	December 31, 2013		September 30, 2013	
(Dollars in millions)	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(Unaudited)			
Revenue forgone	**$ 403**	**$ 465**	**$ 385**	**$ 461**
Total long-term financial assets	**$ 403**	**$ 465**	**$ 385**	**$ 461**
Long-term portion of debt	**$ 5,200**	**$ 5,382**	**$ 5,200**	**$ 5,517**
Total long-term financial liabilities	**$ 5,200**	**$ 5,382**	**$ 5,200**	**$ 5,517**

For the quarter ended December 31, 2013, there were no significant transfers between Level 1 and Level 2 assets or liabilities.

Non-financial assets, such as property and equipment, are measured at fair value when there is an indicator of impairment or when a decision is made to dispose of an asset, and recorded at fair value only when impairment is recognized. Impairment analyses of property and equipment were performed in each quarter of 2013 and the first quarter of 2014. There were no material impairment charges recorded for the quarters ended December 31, 2013 and 2012. Independent appraisals, adjusted for estimated selling costs, are used to determine the fair value of non-financial assets deemed impaired or being held for sale. Independent third party appraisals are deemed Level 2 inputs as defined above.

Note 11 – Revenue Forgone

Revenue forgone is an appropriation that is intended to reimburse the Postal Service for the annual cost of statutorily-required free and reduced rate mailing services to specified groups. It also includes amounts authorized in the *Revenue Forgone Reform Act of 1993* for services performed and revenue forgone for the years 1991 through 1998, which was scheduled to be reimbursed at a rate of $29 million each year from 1993 through 2035.

P.L. 113-76, *Consolidated Appropriations Act, 2014*, which funded the Government for 2014, did not contain a provision for funds to be paid to the Postal Service regarding these amounts due under the *Revenue Forgone Reform Act of 1993*. The Postal Service last received a contribution for the *Revenue Forgone Reform Act of 1993* of $12 million in 2011 and has received none of the combined total of $87 million due for years 2012 through 2014. However, there was no impact to the Statement of Operations as a result of the shortfall in Congressional appropriations for these years because the revenue was previously recognized upon the enactment of the *Revenue Forgone Reform Act of 1993*. The impact of not fully funding these obligations only represents a change in the timing of the funding but not a change to the legal requirement for reimbursement. The unfunded amounts will be included as part of the 2015 and 2016 appropriations requests.

For the three months ended December 31, 2013, the Postal Service recognized revenue of $21 million, including $6 million of imputed interest income from these appropriations, compared to $9 million, including $6 million of imputed interest, for the three months ended December 31, 2012.

The related amount of the noncurrent receivable was $403 million at December 31, 2013, and $385 million at September 30, 2013. The current portion of this receivable was $13 million at December 31, 2013, and $68 million at September 30, 2013, and is recorded under "Receivables – U.S. Government" on the Balance Sheets while the noncurrent portions are shown as "Other Assets."

Item 2 – Management's Discussion and Analysis of Financial Condition and Results of Operations

Cautionary Statements

Forward-looking statements contained in this report represent our best estimates of known and anticipated trends believed relevant to future operations. However, actual results may differ significantly from current estimates. Certain forward-looking statements are included in this report and use such words as "may," "will," "could," "expect," "believe," "plan," "estimate," "project," or other similar terminology. These statements reflect current expectations regarding future events and operating performance as of the date of this report. These forward-looking statements involve a number of risks and uncertainties.

Management's Discussion and Analysis of Financial Condition and Results of Operations and other parts of this report include statements representing expectations about the United States Postal Service business and financial results. These may be impacted by risks and uncertainties discussed here and in the Annual Report on Form 10-K for the year ended September 30, 2013, such as, but not limited to, effectiveness of operating initiatives; rate of electronic diversion; changes in laws and regulations; costs and delays associated with new regulations imposed by the Postal Regulatory Commission (PRC) or other regulatory bodies; the amount of required prefunding payments to the Postal Service Retiree Health Benefits Fund (PSRHBF); success in advertising and promotional efforts; changes in national and local business and economic conditions, including their impact on consumer and business confidence; fluctuations in currency exchange and interest rates; labor and other operating costs; oil, fuel, and other transportation costs; the effects of war and terrorist activities; competition, including pricing and marketing initiatives and new service offerings by our competitors; consumer preferences or perceptions concerning our service offerings; spending patterns and demographic trends; availability of qualified personnel; severe weather conditions; labor relations, particularly the results of collective bargaining; effects of legal claims; cost and deployment of capital; and changes in applicable accounting policies and practices. The foregoing list of important factors is not all-inclusive. Some of these and other factors, many of which we cannot control or influence, may cause actual results to differ materially from those currently contemplated. We have no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise. Operating results for the three month period ended December 31, 2013, are not necessarily indicative of the results to be expected for the year ending September 30, 2014. This report should be read in conjunction with the United States Postal Service Annual Report on Form 10-K for the year ended September 30, 2013. As in that report, all references to years, unless otherwise stated, refer to the fiscal year beginning October 1 and ending September 30. All references to quarters, unless otherwise noted, refer to quarters within fiscal years 2014 and 2013.

Introduction

The United States Postal Service commenced operations on July 1, 1971, as an "independent establishment of the executive branch of the Government of the United States." We are governed by an eleven-member Board of Governors (the Board). Nine independent Governors are appointed by the President of the United States with the advice and consent of the Senate. The Postmaster General, who is appointed by the independent Board members, also serves on the Board, as does the Deputy Postmaster General, who is appointed by the independent Board members and the Postmaster General. Under the *Postal Reorganization Act*, and its successor, the *Postal Accountability and Enhancement Act*, Public Law 109-435 (P.L. 109-435), we have a legal mandate to offer a "fundamental service" to the American people "at fair and reasonable rates." We fulfill this legal mandate to provide universal service at a fair price by offering a variety of classes of mail services without undue discrimination among our customers. This means that, within each class of mail service, prices do not vary unreasonably by customer for the level of service provided. However, P.L. 109-435 provides greater flexibility in the pricing of Shipping Services, as discussed below.

We serve individual and commercial customers in the communications, distribution and delivery, advertising and retail markets throughout the nation and internationally. As a result, we have a very diverse customer base and are not dependent upon a single customer or small group of customers. No single customer represents more than 3% of operating revenue.

Prices and fees are subject to a review process by the Board and by the independent PRC.

P.L. 109-435 classifies postal services into two broad categories: Market-Dominant and Competitive "products"; however, the term "services" is often used in this document for consistency with other descriptions of "services" offered by the Postal Service. Price increases for those services classified as Market-Dominant are subject to a price cap based on the Consumer Price Index — All Urban Consumers (CPI-U). The regulations for Competitive services place no upper limit on price changes, but do set a price floor. Throughout this document and in the day-to-day operations of the organization, we refer to our major service categories as the following: First-Class Mail, Standard Mail, Shipping and Packages, International, Periodicals, and Other. Most services in the First-

Class Mail, Standard Mail, and Periodicals, are in the Market-Dominant category. Shipping and Package Services and International Mail, which are predominantly Competitive services, include, but are not limited to, First-Class and Standard Mail Parcels, Priority Mail, Priority Mail Express, Parcel Select and Parcel Return Service, Bulk Standard Post, and Bulk International Mail. A price increase that was approved by the PRC became effective on January 26, 2014. The Market-Dominant price included a 1.7% increase based on the consumer price index plus a 4.3% increase approved as a temporary exigent rate change. The exigent price change is approved as a surcharge to be collected only until the Postal Service recovers $3.2 billion of incremental revenue above what it would otherwise have recovered through a CPI increase alone. Additionally, prices increased an average of 2.4% for Competitive service products.

Mailing and Shipping Services are sold through a network of nearly 32,000 postal-managed Post Offices, stations, and branches, plus thousands of contract postal units, community post offices, Village Post Offices, retail establishments that sell postage stamps and other services, and our website, *http://www.usps.com*. Mail deliveries are made to over 153 million city, rural, Post Office box, and highway delivery points. Operations are conducted primarily in the domestic market, with international sales representing approximately 5% of total revenue.

We operate and manage a very extensive and integrated retail, distribution, transportation and delivery network. As such, the physical infrastructure and labor force are not, with limited exceptions, dedicated to individual business lines. Expenses are incurred and managed by functional groupings that align with the integrated network structure. Reporting of expenses on a functional basis in this report conforms to the management and structure of expense incurrence within the organization.

The labor force is primarily represented by the American Postal Workers Union, AFL-CIO (APWU), the National Association of Letter Carriers, AFL-CIO (NALC), the National Postal Mail Handlers Union, AFL-CIO (NPMHU), and the National Rural Letter Carriers Association (NRLCA). Approximately 90% of career employees are covered by collective bargaining agreements.

We are required by law to consult with management associations representing supervisory and managerial employees and postmasters prior to making final decisions concerning changes to pay and benefits for such employees.

The Postal Service is not a reporting company under the Securities Exchange Act of 1934, as amended, and is not subject to regulation by the Securities and Exchange Commission (SEC). However, it is required under P.L.109-435 to file with the PRC certain financial reports containing information prescribed by the SEC under Section 13 of the Securities Exchange Act of 1934. These reports include annual reports on Form 10-K, quarterly reports on Form 10-Q, and current reports on Form 8-K, which are available at *http://about.usps.com/who-we-are/financials/welcome.htm*. The Postal Service is required by law and regulations to disclose operational and financial information well beyond what the law requires of other government agencies and most private sector companies.

Pursuant to Title 39 and PRC regulations, additional disclosures on the organization and finances, including Cost and Revenue Analysis reports, Revenue, Pieces, and Weight reports, financial and strategic plans, and the *Comprehensive Statement on Postal Operations* are filed with the PRC and may also be found online at *http://about.usps.com*. Information on the website is not incorporated by reference into this document.

Critical Accounting Judgments and Estimates

The preparation of financial statements in accordance with United States (U.S.) generally accepted accounting principles (GAAP) requires management to make significant judgments and estimates to develop certain amounts reflected and disclosed in the financial statements. In many cases, there are alternative policies or estimation techniques that could be used. We maintain a thorough process to review the application of accounting policies and to evaluate the appropriateness of the many estimates that are required to prepare the financial statements of a large organization. However, even under optimal circumstances, estimates routinely require adjustment based on changing circumstances and new or better information.

The accounting policies deemed either the most judgmental or which involve the selection or application of alternative accounting policies, and are material to the interim financial statements, are described in *Critical Accounting Estimates* contained in *Management's Discussion and Analysis of Financial Condition and Results of Operations* of the Annual Report on Form 10-K for the year ended September 30, 2013. Management discusses the development and selection of accounting policies and estimates with the Audit and Finance Committee of the Board. There have been no significant changes or updates to our Critical Accounting estimates since our last report.

Recent Accounting Standards

There were no new accounting standards issued or adopted during the three months ended December 31, 2013, that had or will have a material impact on our financial statements.

Results of Operations

Three Months Ended December 31, 2013 and December 31, 2012

Our net loss was $354 million for the three months ended December 31, 2013, compared to a net loss of $1,264 million for the same period last year, a favorable decrease of $910 million, or 72%. This was driven by a 1.9% increase in operating revenue, by a 2.9% reduction in compensation and benefits expense and a favorable fair value adjustment to workers' compensation expense of $541 million and $226 million for the three month periods ended December 31, 2013 and 2012, respectively.

Although significant efforts continue to be made to increase revenues and reduce costs under management's control, we have not been able to completely offset declining First-Class mail volume and related revenues. In addition, the PSRHBF prefunding requirement, continuation of legally-mandated six-days-per-week delivery and continued high fuel costs have adversely affected our financial results.

The following table summarizes key operating statistics for the three months ended December 31, 2013 and 2012:

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Key Operating Statistics (Dollars and mail volume per day in millions)	Three Months Ended December 31, 2013		Three Months Ended December 31, 2012	
Operating revenue	$	**17,994**	$	**17,660**
PSRHBF expense	$	**1,425**	$	**1,400**
Net loss	$	**(354)**	$	**(1,264)**
Total mail volume		**42,038**		**43,473**
Average mail volume per day		**561**		**578**

As explained further in the Revenue and Volume section, we continue to make efforts to offset decreases in First-Class Mail revenue and volume. New products, successful marketing campaigns, and growing consumer e-commerce contribute to the growth in our package business. Through the introduction of new service offerings and better educational marketing information, we are showing customers new ways that the mail can be used in conjunction with current technologies. We continue to encourage mailers to try new products and services that can add value to their mail and connect with customers in a more individualized way. Products and services, such as Every Door Direct Mail, and ePostage, offer new ways of doing business with us. Customers are also increasingly using free package pickup during carrier route deliveries.

Our net losses include expenses for the legally-mandated prefunding of retiree health benefits, as well as the legally-mandated participation in the federal workers' compensation program that is managed by the Department of Labor's (DOL's) Office of Workers' Compensation Programs (OWCP) and governed by the FECA. Under FECA, workers' compensation claims cannot be settled through lump-sum payments. Rather, compensation is paid over many years. As the Postal Service does not manage the FECA program, we have no ability to control the significant administrative costs. These factors, compounded by cost of living adjustments (COLA) granted by Federal Law to those claims, result in substantially higher costs to the Postal Service than would likely be the case if claims management decisions were made by the Postal Service. In addition to the constraints imposed by the legally-mandated FECA program, actuarial estimations and projected cash payments that will be paid well into the future also have substantial impact on our reported workers' compensation liability. Future cash payments must be converted to present-day dollars, or discounted, by applying current rates at which the liability could theoretically be settled. Discount rates can fluctuate significantly from period to period with changes in the economic and interest rate environment. Even a small change in discount rates can have a large impact on the workers' compensation liability and expense, as a 1% decrease in rates at December 31, 2013, would have resulted in a $2.0 billion increase of the liability. This results in the GAAP workers' compensation expense varying significantly from our cash outlays.

Because the legislative mandates for prefunding of retiree health benefits and the participation in the FECA are not subject to management's control, we believe that analyzing operating results without the impact of certain of these charges provides a more meaningful insight into current operations. In the day-to-day operation of our business, we exclude these items from our internal financial analyses in order to direct focus upon relevant expenses that management can control and include only those workers' compensation costs representing current year payments on behalf of postal claimants. The following table illustrates the loss from ongoing business activities when these charges are not considered, and reconciles this amount to our GAAP net loss.

Net Income before Impact of Expense Related to the Long-term Portion of Workers' Compensation and PSRHBF Expense				
	Three Months Ended December 31,			
(Dollars in millions)		2013		2012
Net loss	$	(354)	$	(1,264)
Impact of:				
Change related to the long-term portion of workers' compensation		(306)		8
PSRHBF expense		1,425		1,400
Net income before impact of expense related to long-term portion of workers' compensation and PSRHBF expense	$	765	$	144

Without the impact of these non-controllable factors, net income would have been $765 million for the quarter ended December 31, 2013, compared to a net income of $144 million for the quarter ended December 31, 2012.

Revenue and Volume

For the three months ended December 31, 2013, operating revenue was $17,994 million, an increase of $334 million, or 1.9%, compared to the same period last year. Shipping and Packages revenue of $3,882 million increased $479 million, or 14.1%, compared to the same period last year. Shipping and Packages volume was 1,114 million pieces for the three months ended December 31, 2013, an increase of 104 million pieces, or 10.3%, compared to the same period last year. Increased consumer spending, e-commerce retail sales, and increasingly effective marketing efforts were responsible for the growth in Shipping and Packages revenue and volume during the three months ended December 31, 2013.

Summary of Revenue and Volume Results

Revenue and volume are closely linked to the strength of the U.S. economy and changes in how our customers use the mail. Revenue growth is constrained by laws and regulations restricting the types of products and services we can offer and by our ability to implement products and services and the speed with which we can bring them to market.

As discussed in detail below, the impact of technological change and the Great Recession has impacted our First-Class Mail revenue which continues to decline even as new services, the growth of e-commerce, and successful marketing campaigns, have helped us grow our Shipping and Packages business. However, because Shipping and Packages represents 18.6% of our total annual revenues, these increases cannot fully offset the declines in First-Class Mail revenue and volume. Furthermore, the profit contribution for First-Class Mail is greater than that of packages. As a result, revenues from Shipping and Package Services would have to grow at a substantially higher rate than the decline in First-Class Mail revenues in order to replace the profit contribution of First-Class Mail.

The following table summarizes our revenue and volume for the three months ended December 31, 2013 and 2012, by major service line:

Operating Revenue and Volume by Service Line *						
	For the Three Months Ended December 31,					
	2013		2012		Revenue	Volume
(Dollars and pieces in millions)	Revenue	Volume	Revenue	Volume	% Change	% Change
First-Class Mail[1]	$ 7,290	16,881	$ 7,499	17,698	(2.8)%	(4.6)%
Standard Mail[2]	4,628	21,993	4,634	22,622	(0.1)%	(2.8)%
Shipping and Packages[3]	3,882	1,114	3,403	1,010	14.1 %	10.3 %
International	866	266	831	269	4.2 %	(1.1)%
Periodicals	409	1,564	426	1,641	(4.0)%	(4.7)%
Other[4]	919	220	867	233	6.0 %	(5.6)%
Total revenue and volume	$ 17,994	42,038	$ 17,660	43,473	1.9 %	(3.3)%

*Note: The totals for certain mail categories for the prior year have been reclassified to better reflect classifications used in the current year. These reclassifications did not impact total operating revenue for the prior year.

[1] Excludes First-Class Mail Parcels.

[2] Excludes Standard Mail Parcels.

[3] Includes Priority Mail, Standard Post, Parcel Select Mail, Parcel Return Service Mail, Standard Mail Parcels, Package Service Mail, First-Class Mail Parcels, First-Class Package Service, and Priority Mail Express.

[4] Includes PO Box Services, Certified Mail, Return Receipts, Insurance, Other Ancillary Fees, Shipping and Mailing Supplies, and other operating revenue.

First-Class Mail and Standard Mail continue to provide the majority of our revenue for the quarter ended December 31, 2013, despite trends away from hard copy to electronic media. First-Class Mail represents 41% of our revenue and accounts for 40% of the mail volume while Standard Mail generates 26% of revenue, but 52% of volume. Shipping and Packages generated approximately 22% of our revenue despite representing only 3% of our volume.

FIRST-CLASS MAIL

First-Class Mail, our most profitable service category, had revenue of $7,290 million for the three months ended December 31, 2013, a decrease of $209 million, or 2.8%, compared to the same period last year. The corresponding volume decrease was 817 million pieces, or 4.6%. The most significant factors contributing to this decline were the continuation of trends associated with changes in the behavior of consumers and businesses emanating from the Great Recession, and the continuing migration toward electronic communication and transactional alternatives.

STANDARD MAIL

Standard Mail had revenue of $4,628 million for the three months ended December 31, 2013, a decrease of $6 million, or 0.1%, compared to the same period last year. The corresponding volume decrease was 629 million pieces, or 2.8%. The decrease was primarily the result of 2012 being an election year, which generated significant political mail volume in Quarter I of last year.

SHIPPING AND PACKAGES

The following table summarizes our revenue and volume for Shipping and Packages for the three months ended December 31, 2013, and 2012, by service line:

Shipping & Packages Revenue and Volume *							
	For the Three Months Ended December 31,						
	2013			2012		Revenue	Volume
(Dollars and pieces in millions)	Revenue	Volume		Revenue	Volume	% Change	% Change
Priority Mail[1]	$ 2,161	274	$	1,962	256	10.1 %	7.0 %
Parcel Select, Parcel Return, and Standard Parcels	758	447		577	392	31.4 %	14.0 %
Package Services	209	151		208	147	0.5 %	2.7 %
First-Class Packages[2]	558	233		448	205	24.6 %	13.7 %
Priority Mail Express	196	9		208	10	(5.8)%	(10.0)%
Total revenue and volume	$ 3,882	1,114	$	3,403	1,010	14.1 %	10.3 %

*Note: The totals for certain mail categories for the prior year have been reclassified to better reflect classifications used in the current year.

[1] Includes Standard Post.

[2] Includes First-Class Mail Parcels and First-Class Package Services.

Shipping and Packages revenue continued to show solid growth for the three months ended December 31, 2013, compared to the same period last year. Shipping and Packages revenue increased $479 million, or 14.1% from $3,403 million in the three months ended December 31, 2012, to $3,882 million in the three months ended December 31, 2013. The increases are reflective of our successful efforts to gain market share and compete in the ground shipping services and "last mile" e-commerce fulfillment markets. Additionally, the 2013 holiday season provided a surge in package volume as we took advantage of consumers' growing use of online shopping. In order to accommodate this surge in volume, we implemented Sunday delivery service in limited U.S. markets.

Priority Mail

Priority Mail, which represented 55.7% of total Shipping and Packages Service revenue, increased $199 million, or 10.1%, for the three months ended December 31, 2013, compared to the same period last year. Priority Mail Flat Rate advertising campaigns continued to contribute to increased revenues in that category. We continue to simplify our Priority Mail service to better meet the needs of the public and introduced the new *"Priority You"* marketing campaign in 2013. E-commerce has grown at a higher rate than traditional retail sales, which has helped to boost Priority Mail revenues.

Parcel Services

Parcel Services revenue was $758 million for the three months ended December 31, 2013. This category includes Parcel Select revenue of $706 million, Parcel Returns revenue of $34 million, and Market-Dominant Standard Mail Parcels revenue of $18 million. This was an overall increase of $181 million, or 31.4%, compared to the same period of the prior year. These services showed strong volume growth of 14.0%, during the three months ended December 31, 2013, compared to the same period of the prior year. However, these packages represent one of our lowest available priced services, and as a result, they provide a relatively lower level of profitability than many of our other services.

Package Services

Package Services revenue was $209 million for the three months ended December 31, 2013, an increase of $1 million, or 0.5%, compared to the same period last year. Package services volume increased 4 million pieces, or 2.7%. This category includes Parcel Post, Bound Printed Matter, Library Mail and Media Mail weighing up to 70 pounds.

Because all services in this category are classified as Market-Dominant, price increases for these services are capped.

First-Class Packages

The First-Class Package Services category was introduced in 2012. This reliable package service offers commercial customers that ship primarily lightweight fulfillment parcels, the lowest priced package option in the marketplace. First-Class Packages, which include the competitively priced First-Class Package Services, a commercial under one pound package product, and First-Class Mail Parcels, a Market-Dominant under 13 ounce package product, generated revenue of $558 million for the three months ended December 31, 2013, an increase of $110 million, or 24.6%, compared to the same period last year. Volume increased 28 million pieces, or 13.7%, for the three months ended December 31, 2013, compared to the same period last year.

INTERNATIONAL MAIL

International mail revenue was $866 million for the three months ended December 31, 2013, an increase of $35 million, or 4.2%, compared to the same period last year. Pricing increases resulted in revenue growth for this category.

PERIODICALS

Periodicals revenue was $409 million for the three months ended December 31, 2013, a decrease of $17 million, or 4.0%, compared to the same period last year. Periodicals volume decreased by 77 million pieces for the three months ended December 31, 2013, or 4.7%, compared to the same period last year. The percentage decrease in volume is primarily off-set to a price increase implemented thereby mitigating further decreases in revenue. Trends in hard-copy reading behavior and shifts of advertising away from print have been depressing this segment for years. Therefore, Periodicals are not expected to rebound as e-readers and electronic content continue to grow in popularity with the public.

OTHER

Other revenue includes Market-Dominant and Competitive ancillary services such as Certified Mail, P.O. Box services, return receipts, delivery confirmation, and shipping services. In addition, other revenue generated from miscellaneous items such as the sales of money orders, passport services, and the gain from the sale of real estate are also included in this category.

Operating Expenses

The following table summarizes our major categories of operating expenses for the three months ended December 31, 2013 and 2012:

Operating Expenses	Three Months Ended December 31,	
(Dollars in millions)	2013	2012
Compensation and benefits	$ 12,102	$ 12,467
Retiree health benefit premiums	728	678
PSRHBF prefunding	1,425	1,400
Workers' compensation	-	324
Transportation	1,779	1,839
Other expenses	2,272	2,172
Total operating expenses	$ 18,306	$ 18,880

COMPENSATION AND BENEFITS

Compensation and benefits expenses consist of costs related to our active career and non-career employees including compensation expense, retirement expense, health benefits expense and other miscellaneous expenses more fully described below.

Compensation expense. Compensation expense was $9,320 million for the three months ended December 31, 2013, compared to $9,599 million in the same period last year, a decrease of $279 million, or 2.9%. During the three months ended December 31, 2012, we recorded an expense of $92 million related to a voluntarily early retirement incentive offer. Excluding the impact of the additional expense related to the incentive offer, compensation expense would have decreased by $187 million, or 2.0%. The decrease is primarily due to our continuing efforts to increase operational efficiency and respond to the decline in mail volume.

The decrease in compensation expense is primarily driven by changes in the staffing composition between career and non-career employees in the workforce. As of December 31, 2013, the number of career employees was reduced by approximately 33,000 or 6% compared to December 31, 2012. These reductions have been accomplished primarily through attrition and incentives to retire or resign. The number of non-career employees increased by approximately 27,000, or 23% since December 31, 2012 as a result of the increased workforce flexibility available under the new collective bargaining agreements. This increased flexibility allowed us to more efficiently manage the workforce and reduce the average cost per work hour.

Total work hours also continue to decline despite the increased number of delivery points and growth in our Shipping and Packages business. Work hours for the quarter ended December 31, 2013, reduced by approximately 1 million hours, or 0.4%, compared to the same period last year. We achieved this decrease despite a 10.3% volume increase for Shipping and Packages – our products with the highest levels of workload, compared to the same period last year.

Retirement and health benefits expense – current employees. Postal Service employees participate in one of three retirement programs of the U.S. Government, see Note 7, *Retirement Programs*, in the Notes to the Financial Statements. All expenses of the retirement programs, except for retiree health benefits, are included in compensation and benefits expense. Retirement expense was $1,462 million for the three months ended December 31, 2013, compared to $1,481 million for the same period last year, a decrease of $19 million, or 1.3%. The decrease is primarily due to the reduced number of career employees when compared to the same period last year.

Health benefits expense was $1,222 million for the three months ended December 31, 2103, compared to $1,286 million for the same period last year, a decrease of $64 million, or 5.0%. Our share of the health care premiums for our employees represents 77% and 78% of the total health care premium cost for the three months ended December 31, 2013 and 2012, respectively. The decrease in health benefits expense was driven by a reduction in career employee headcount as noted above, and to lower health care contribution percentages for certain categories of employees, consistent with our contractual agreements. However, these favorable factors were largely offset by an average premium increase of 3.4% for employees participating in the FEHB during the year ended December 31, 2013.

RETIREE HEALTH BENEFIT PREMIUMS AND PSRHBF PREFUNDING

We participate in federal employee benefit programs for retirement, health and workers' compensation benefits. Under P.L. 109-435, we are obligated to fully fund the employer's portion of the established health and retirement benefits of current retirees and current postal employees who have not yet retired. The law established the Postal Service Retiree Health Benefits Fund (PSRHBF). The law requires the Postal Service to pay into the PSRHBF, $55.8 billion in 10 annual installments through 2016. While P.L. 109-435 dictates the amounts and timing of payments, the amounts to be paid and the timing of the payments can be rescheduled at any time with the passage of a new law, or amendment of the existing law.

As previously reported in our Annual Report on Form 10-K for the year ended September 30, 2013, we defaulted on the legally required PSRHBF payments due in 2013 and 2012 of $16.7 billion in total. We have recorded $18.1 billion as a current liability for the PSRHBF prefunding requirements. This includes the $16.7 billion due for defaulted payments and an accrual of $1.4 billion related to the $5.7 billion payment due by September 30, 2014. Absent legislative change, we see no current means to satisfy the future payment of $5.7 billion due by September 30, 2014, and we will be forced to default when that payment becomes due.

Current law also obligates us to make additional payments of $5.7 billion in 2015, and $5.8 billion in 2016, due by September 30 of each respective year. However, given the low levels of our cash resources, we expect to be forced to default on these prefunding payments and prioritize payments to our employees and our suppliers, in order to ensure that we will continue to be able to fulfill our other statutory obligations, including our obligation to provide universal mail service to the nation (as discussed in *Note 2, Liquidity*, in the Notes to the Financial Statements). The statutory requirement establishing the payment schedule (P.L. 109-435) contains no provisions addressing a payment default. As of February 7, 2014, no penalties or adverse consequences have resulted.

Under current law, not later than 2017, the Office of Personnel Management (OPM) will conduct an actuarial valuation and determine whether any further payments into the PSRHBF are required. If additional payments are required, OPM will design a schedule to fully amortize the remaining liability, by 2056. Beginning in 2017, the PSRHBF will begin to pay the Postal Service's portion of the retiree health premiums. Also beginning in 2017, we are to fund the actuarially determined normal cost, plus any required amortization of the unfunded liability.

Under P.L. 109-435, we pay the premiums for postal retirees participating in the Federal Employees' Health Benefits Program (FEHBP), and we continue to expense these payments as they become due, at a cost of $728 million for first quarter of 2014, an increase of $50 million or 7.4% from the same period last year. The major drivers of retiree health benefits premium costs are the number of retirees and survivors receiving health benefits, the mix of plans selected by retirees, the premium costs of those plans, and the portion of premium costs allocated to the Federal Government for retiree service prior to 1971. As of December 31, 2013, there were approximately 490,000 participants, a net increase of approximately 15,000 since December 31, 2012. In addition to the growth in the number of plan participants, retiree health benefit premium expense also increased due to an increase in the cost of premiums.

The components of retiree health benefits expense for the three month periods ended December 31, 2013, and 2012, are as follows:

Retiree Health Benefits	**Three Months Ended December 31,**	
(Dollars in millions)	**2013**	**2012**
(Unaudited)		
Employer premium expense	**$ 728**	**$ 678**
Accrual for P.L. 109-435 payment to PSRHBF	**1,425**	**1,400**
Total retiree health benefits expense	**$ 2,153**	**$ 2,078**

Although no PSRHBF prepayments were made during the first three months of the year, the expense has been accrued, in order to properly reflect the portion of the required annual payment allocable to Quarter I.

WORKERS' COMPENSATION

Postal employees injured on the job are covered by the FECA, administered by DOL's OWCP, which makes all decisions regarding injured workers' eligibility for benefits. However, we annually reimburse the DOL for all workers' compensation benefits paid to or on behalf of postal employees, and pay an administrative fee to the DOL.

An estimation model that combines four generally accepted actuarial valuation techniques is used to project future claim payments based upon past claim-payment experience and exposure to claims as measured by total hours worked by Postal employees. Open claims and past claim payment experience are data inputs to the model that are supplied by the DOL. The data required to update the model for the quarter ended December 31, 2013 was not received from DOL in a timely manner. Therefore, we have estimated the workers' compensation liability using the model's projected claims for the current period based upon actual data from the periods ending on or prior to June 30, 2013.

A liability is recorded for the present value of estimated future payments to postal employees, or their qualified survivors, who have been injured through the end of the reporting period.

The liability for estimated future workers' compensation payments is recorded at its present value. To record the liability and annual expense, an estimate is made of the amount of funding that would need to be invested at current interest rates in order to fully fund all estimated future payments. Inflation and discount (interest) rates are updated as of the date of the financial statements to determine the present value of the workers' compensation liability at fair value in accordance with GAAP. The impact of changes in the discount and inflation rates is accounted for as a change in accounting estimate and included in operating expenses.

The estimation of the liability is highly sensitive to changes in inflation and discount rates. An increase of 1% in the discount rate would decrease the liability and expense by approximately $1.6 billion. A decrease of 1% in the discount rate would increase the liability and expense by $2.0 billion.

At December 31, 2013, the present value of the liability for future workers' compensation payments was $15,902 million, after making the scheduled annual payment of $1,372 million on October 15, 2013, which included $50 million of prepaid administrative fees. The liability at September 30, 2013 was $17,240 million which represents a decrease of $1,338 million. The current portion of the 2014 liability was $1,391 million at December 31, 2013, compared to $1,322 million at September 30, 2013.

Changes in the workers' compensation liability are attributable to the combined impact of changes in the discount and inflation rates, routine changes in actuarial estimation, new compensation and medical cases, and the progression of existing cases. Workers' compensation expense, including the impact of changes in the discount rates, was zero and $324 million for the three month periods ended December 31, 2013, and 2012, respectively.

On a quarterly basis, changes in the number of claims and amounts paid are highly volatile and depend on a number of factors including, but not limited to, the following: the number, timing and severity of injuries; the number of new claims and closed claims within the period; and the amount and timing of payments made by the OWCP on our behalf. Medical and compensation claims payments fluctuate significantly from quarter to quarter so the change in the number of paid medical and compensation claims for any quarter compared to the same period last year may not necessarily be representative of the results to be expected for the full year. We experienced a $10 million, or 3.2%, decrease in compensation and medical claim payments for the three months ended December 31, 2013, compared to the same period last year. Additional information regarding the inputs, assumptions, estimates and historical information for workers' compensation are available in *Note 9 – Workers Compensation.*

As noted above, we are legally-mandated to participate in the federal workers' compensation program that is managed by the DOL OWCP and governed by FECA. Under FECA, workers' compensation claims for many types of injuries cannot be settled through lump-sum payments. Rather, compensation may be paid over many years. As the Postal Service does not manage the FECA program, we have no ability to control the significant administrative costs. These factors, compounded by COLA adjustments granted by Federal Law to those claims, results in substantially higher costs to the Postal Service than would likely be the case if claims management decisions were made by the Postal Service. In addition to the constraints imposed due to the legally-mandated FECA program, actuarial estimations and projected cash payments that will be paid well into the future also have substantial impact on our reported workers' compensation liability and expense. Future cash payments must be converted to present-day dollars, or discounted, by applying the current rates at which the liability could theoretically be settled. Discount rates can fluctuate significantly from period to period with changes in the economic and interest rate environment.

For the quarters shown, the table below highlights the differences between actual claims paid on behalf of Postal Service workers' compensation obligations compared to the total recognized workers' compensation expense that includes fluctuations in discount rates, inflation rate increases, and amounts that may not be paid until well into the future.

Workers' Compensation Expense	Three Months Ended December 31,	
(Dollars in millions)	**2013**	**2012**
(Unaudited)		
Total workers' compensation expense	**$ -**	**$ 324**
Claims paid on behalf of Postal Service's workers' compensation obligations	**306**	**316**
Expense related to the long-term portion of workers' compensation	**$ (306)**	**$ 8**

TRANSPORTATION

Transportation expense consists primarily of highway, air, and international transportation costs. Transportation expense for the three months ended December 31, 2013, was $1,779 million, a decrease of $60 million, or 3.3%, compared to $1,839 million for the same period last year.

The following table summarizes the components of transportation expense:

Transportation Expense (Dollars in millions)		**Three Months Ended December 31, 2013**		**2012**
(Unaudited)				
Highway transportation	**$**	**939**	**$**	**908**
Air transportation		**564**		**641**
International transportation		**264**		**279**
Other transportation		**12**		**11**
Total transportation expense	**$**	**1,779**	**$**	**1,839**

Highway transportation expenses were $939 million for the three months ended December 31, 2013, compared to $908 million for the same period last year, an increase of $31 million, or 3.4%. This increase is primarily attributable to greater surface transportation expenses due to the increase in Shipping and Packaging volume during the first quarter of 2014.

Air transportation expenses were $564 million for the three months ended December 31, 2013, compared to $641 million for the same period last year, a decrease of $77 million, or 12.0%. The decline in air transportation expenses is primarily attributable to the new air cargo contract that was implemented in October of 2013. Lower courier rates and jet fuel costs were the main drivers of the decline in air transportation expenses.

International transportation expenses were $264 million for the three months ended December 31, 2013, compared to $279 million for the same period last year, a decrease of $15 million, or 5.4%. The decrease is attributable to a decline in the International Express and International Priority volumes.

OTHER EXPENSES

Other operating expenses were $2,272 million for the three months ended December 31, 2013, compared to $2,172 for the same period last year, an increase of $100 million, or 4.6%. The increase is primarily due to the shipping and package rebranding. These expense increases were concentrated in supplies and services of $69 million, vehicle maintenance service of $18 million, information technology and communications of $25 million, offset in part by a decrease in depreciation and amortization of $20 million.

Liquidity and Capital Resources

CASH FLOW ACTIVITY

Unrestricted Cash and cash equivalents totaled $3,754 million at December 31, 2013, compared to $2,326 million at September 30, 2013, respectively, an increase of $1,428 million.

The following table provides a summary of our cash flows for the three month periods ended December 31, 2013, and 2012:

Cash Flow Statement (Dollars in millions)	**Three Months Ended December 31, 2013**	**2012**
(Unaudited)		
Operating activities:		
Net loss	**$ (354)**	**$ (1,264)**
Noncash depreciation and gains on sales	**434**	**486**
Changes in assets and liabilities	**1,484**	**1,535**
Net cash provided by operating activities	**1,564**	**757**
Investing activities:		
Capital expenditures, net of proceeds	**(150)**	**(137)**
Other	**40**	**(69)**
Net cash used in investing activities	**(110)**	**(206)**
Financing activities:		
Other	**(26)**	**(27)**
Net cash used in financing activities	**(26)**	**(27)**
Net increase in cash and cash equivalents	**$ 1,428**	**$ 524**

Operating Activities: Operating activities generated $1,564 million of cash during the three months ended December 31, 2013, compared to $757 million for the three months ended December 31, 2012, an increase of $807 million. The increase in cash generated from operating activities was primarily due to the increased revenues in of our Shipping and Packages and First-Class Packages service offerings during the current quarter as well as reduced operating expenses.

Investing Activities: Purchases of property and equipment were $182 million for the three months ended December 31, 2013, compared to $166 million in the same period last year, an increase of $16 million, or 9.6%. Proceeds from the sale of property and equipment were $32 million and $29 million for the three months ended December 31, 2013, and 2012, respectively.

Financing Activities: In addition to the cash generated by operations, we use credit lines and notes payable to the Federal Financing Bank to help fund operations. During the three months ended December 31, 2013 and 2012, we issued and repaid $2,700 million, in notes payable resulting in zero net issuance. There was no change in our revolving credit line from our September 30, 2013, balance of $4,000 million.

LIQUIDITY CHALLENGES

LIQUIDITY CONCERNS

We continue to suffer from a lack of liquidity. We held unrestricted cash of $3.8 billion and $2.3 billion as of December 31, and September 30, 2013, respectively, and had no remaining borrowing capacity on our $15 billion debt facility (See *Note 3, Debt*, for additional information). The increase in our cash balance for the quarter is largely attributable to the seasonal impact of holiday mailings and timing differences related to the payment of liabilities. The current positive cash balance exists only due to defaults on $16.7 billion of the legally-mandated prefunding payments due to the PSRHBF in 2012 and 2013. Additionally, we anticipate that we will be unable to make our next $5.7 billion payment due by September 30, 2014, and we have no ability to borrow additional funds. As of the date of this report, February 7, 2014, we have incurred no penalties or negative consequences resulting from our inability to make these payments. We do not have sufficient liquidity to make meaningful reductions in our debt and important investments in our infrastructure. Further, this level of cash could be insufficient to support operations in the event of another significant downturn in the U.S. economy.

Our net loss was $354 million for the first quarter of the year, which includes $1.4 billion of expense accrued for the legally-mandated prefunding payment for retiree health benefits. The requirement of the *Postal Accountability and Enhancement Act,* Public Law 109-435 (P.L. 109-435) to prefund our retiree health benefit obligations, a requirement not shared by other federal agencies or private sector businesses, plus the ongoing decline in First-Class mail volume caused by changes in consumers' and businesses uses of mail resulting from the Great Recession and the continuing migration toward electronic communication and transactional alternatives, have been major factors contributing to our losses. Without structural change to our business model, we will continue to be negatively impacted by these factors and, absent legislative change, we anticipate continuing quarterly losses for the remainder of 2014.

We were able to make our annual payment of approximately $1.4 billion to reimburse the DOL for workers' compensation expenses in October 2013. However, current projections indicate that we will continue to have a low level of liquidity throughout 2014. Absent legislative action to assist the Postal Service in returning to a financially stable position, this low level of liquidity will continue to exist.

In the event that circumstances leave us with insufficient cash, we would be required to implement contingency plans to ensure that mail deliveries continue. These measures could require us to prioritize payments to our employees and to our suppliers ahead of some payments to the Federal Government, as has been done in the past. Additionally, we continue to seek a refund of the overfunding of the Federal Employees' Retirement System (FERS) as those funds would help alleviate some of our short-term liquidity risks. The latest available information from the OPM estimates that the FERS overfunding was $500 million at September 30, 2013. The Office of the Inspector General has determined that if our specific assumptions were used to estimate the FERS obligation, rather than the government-wide averages currently used, the surplus would be significantly greater than the amount calculated by OPM.

POSTAL ACTIONS TAKEN TO IMPROVE LIQUIDITY

In 2013, our Board of Governors directed management to accelerate the realignment of our operations to further reduce costs in order to strengthen our finances, citing the fact that we cannot wait indefinitely for legislation. Additionally, we have leveraged employee attrition from the Voluntary Early Retirement (VER) and increased utilization of non-career employees, as provided by the new labor agreements, which allowed for better alignment of staffing and workload levels, resulting in reduced labor costs.

In February 2013, we announced plans to transition to a new delivery schedule which would include package delivery Monday through Saturday and mail delivery Monday through Friday; however we were unable to implement these plans due to legislative constraints. The transition to a more cost-effective delivery schedule remains one of the most significant savings opportunities available to us and remains a part of the *2013 Five-Year Business Plan* (Business Plan). We continue to request comprehensive legislation that will enable changes to the business model and allow a transition to a new delivery schedule and remain hopeful that future legislation will change the 6-day delivery requirement.

In April 2013, we released our updated comprehensive Business Plan which details the implementation of our targeted program to eliminate nearly $20 billion of annual cost from the business by the year 2017. This plan continues our efforts to aggressively pursue the strategies within our control to increase operational efficiency and to improve our liquidity position. The Business Plan requires a combination of operational realignment, aggressive cost reductions, and comprehensive legislation to reform our current business model. Several key provisions included in the Business Plan, in addition to the modified delivery schedule, are outlined below:

- Alignment of network size and cost to manage reduced mail volumes;
- Revenue management to introduce new service offerings to generate new revenue and slow the migration of existing revenue streams to electronic alternatives;
- Implementation of a new healthcare program and integration of this plan with Medicare to provide postal employees and retirees with actuarially equivalent benefits at a lower cost;
- Changes to our business and governance model will assist the Postal Service in restoring to a position of financial viability in the long run.

In September 2013, we requested and the PRC subsequently approved price increases on Market-Dominant and Competitive products. The Market-Dominant increases include a 1.7% price increase based on the consumer price index plus a 4.3% increase approved by the PRC in December 2013 as a temporary exigent rate change. The exigent change is approved as a surcharge to be collected only until we recover $3.2 billion of incremental revenue above what we would otherwise have recovered through a CPI increase alone. We are appealing the temporary nature of this change. Additionally, prices increased an average of 2.4% for Competitive products. These Market-Dominant and Competitive products changes went into effect on January 26, 2014 and are expected to generate approximately $2.7 billion of additional annualized revenue for the Postal Service.

MITIGATING CIRCUMSTANCES

The Postal Service's status as an independent establishment of the executive branch does not receive tax dollars for our operations presents unique requirements and restrictions, but also potentially mitigates some of the financial risk that would otherwise be associated with a cash shortfall. With revenues of $67 billion, generated almost entirely through the sale of postage and delivery services, a financially sound Postal Service is vital to American commerce. The U.S. economy benefits greatly from the Postal Service and the many businesses that provide the printing and mailing services that support it. Disruption of the mail would cause undue hardship to businesses and consumers. Therefore, it is unlikely that, in the event of a cash shortfall, the Federal Government would allow the Postal Service to significantly curtail or cease operations.

We continue to inform the Administration, Congress, the PRC, and other stakeholders of the immediate and longer-term financial challenges we face and the legislative changes that would help restore financial stability. We will continue to pursue legislative changes, cost reductions, and additional ways to generate revenues in 2014. Many of the structural reforms needed to ensure long-term viability, such as adjustments to the retiree health benefit pre-funding payment schedule and changes to delivery standards, can only be achieved with legislative change. Given the vital role that we play in the U.S. economy, we are hopeful that legislation will be enacted which will mitigate our short-term financial challenges and provide us with the authority to make needed changes to ensure long-term financial stability. However, there can be no assurances that the requests to restructure the PSRHBF prefunding payment schedule, or any other legislative changes, will be made in time to impact 2014, or at all.

Legal Matters and Contingent Liabilities

An estimated loss contingency is accrued in our financial statements if it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. Assessing contingencies is highly subjective and requires judgments about future events. We regularly review loss contingencies to determine the adequacy of our accruals and related disclosures. The amount of the actual loss may differ significantly from these estimates. As of December 31, 2013, our estimate of our liability for material claims increased by $43 million to $982 million from $939 million at September 30, 2013.

Fair Value Measurements

As required by authoritative accounting literature, certain fair value disclosures for the three months ended December 31, 2013, are contained in the Notes to the Financial Statements. We did not recognize gains as a result of valuation measurements during Quarter I, 2014. All recognized losses have been incorporated into our financial statements as of December 31, 2013. See *Note 10-Fair Value Measurements.*

LEGISLATIVE UPDATE

The first quarter of Fiscal Year (FY) 2014 for the Postal Service encompassed the closing months of the First Session of the 113th Congress. The two major postal reform bills, which were introduced in the First Session, were not enacted. The Senate and House bills, S. 1486, the *Postal Reform Act of 2013* and H.R. 2748, the *Postal Reform Act of 2013*, are still pending legislative action in the Second Session, and are discussed in detail below.

As the debate on postal legislation continues in the 113th Congress, a number of reforms are urgently needed. The Postal Service's key legislative requirements include:

- Require USPS Health Care Plan, either within or outside of the Federal Employees Health Benefit (FEHB) Program, that would virtually eliminate the PSRHBF unfunded liability.
- Refund FERS overpayment and adjust future FERS payment amount.
- Adjust delivery frequency (six-day packages/five-day mail).
- Streamline governance model and eliminate duplicative oversight.
- Provide authority to expand products and services.
- Require defined contribution retirement system for future postal employees.
- Require arbitrators to consider the financial condition of the Postal Service.
- Reform Workers' Compensation.

Appropriations

On January 17, 2014, the President signed into law H.R. 3547 (P.L. 113-76), the *Consolidated Appropriations Act, 2014,* making appropriations for the fiscal year ending September 30, 2014. The bill includes a payment to the Postal Service Fund of $70.8 million for revenue forgone on free and reduced rate mail, which shall not be available until October 1, 2014. A condition of payment is that mail for overseas voting, and mail for the blind, continue to be provided for free. Also, 6-day mail delivery must continue at not less than the 1983 level. Additionally, none of the funds made available should be used to consolidate or close small rural or other small Post Offices in FY 2014. No funds were provided for provisions related to the *Revenue Forgone Act of 1993*, which authorizes the Postal Service to receive $29 million annually through 2035 as reimbursement for services it provided from FY1991 through FY1998.

Major Congressional Postal Reform Proposals

Postal Reform Act of 2013, S. 1486

On August 1, 2013, the *Postal Reform Act of 2013* was introduced in the Senate. The bill provides for reform on a variety of issues, including Postal Service pensions, health care, workers' compensation, operations, ratemaking, governance, innovation, and other areas.

On February 6, 2014, the Senate Homeland Security and Governmental Affairs Committee passed S. 1486, as amended, by a strong bipartisan margin of 9-1. The measure is pending consideration by the full Senate.

Postal Reform Act of 2013, H.R. 2748

On July 19, 2013, H.R. 2748, the *Postal Reform Act of 2013*, was introduced in the House. H.R. 2748 would allow the Postal Service to establish a five-day mail delivery schedule while temporarily mandating six-day package delivery for domestic competitive products. It would allow the Postal Service to forgo past-due payments to prefund retiree health benefits and would eliminate the FY 2014 payment. Starting in 2015, required payments to prefund retiree health benefits would be based on an actuarial calculation designed to achieve full funding in 2056, while current retiree health benefits premiums would be paid out of the PSRHBF. H.R. 2748 would replace the current Board of Governors with a panel of five full-time executives. Once the Postal Service met certain specified financial requirements, the panel would be dissolved and replaced with a smaller Board of Governors that would initially be comprised of the panel members.

H.R. 2748 would begin to phase out door delivery of mail in favor of curbside and clusterbox delivery, except in cases where eliminating door delivery is infeasible, where customers pay for continued door delivery, or where customers have a significant hardship requiring that they receive door delivery. The bill would also require above-CPI increases in the prices of postal products for which costs exceed revenues and would not permit political committees to use the non-profit Standard Mail rate. The bill would require postal workers to pay the same premiums paid by other federal workers for health and life insurance benefits and seeks to clarify the compensation parity currently required between Postal and private sector workers. H.R. 2748 would allow the Postal Service to offer state and local government services, such as, the sale of fishing licenses. The bill seeks to create a mechanism to allow the FERS surplus to be transferred to the PSRHBF to the extent that the surplus exceeds any unfunded liability in CSRS and would allow the use of Postal Service-specific economic assumptions to calculate liabilities and annual payments for both the FERS and the CSRS pension systems. It also specifies that, in the future, postal employees would be subject to the same Reduction-in-Force (RIF) authority as the rest of the federal workforce.

H.R. 2748 would limit the closure of rural Post Offices and would require the Postal Service to consider broadband penetration, cellular phone service, and the distance to the closest alternate access point when determining whether to close a Post Office. It would create a Chief Innovation Officer position responsible for identifying and growing new postal and authorized non-postal products and would also raise the current revenue limit on experimental product market tests.

The House Oversight and Government Reform Committee amended and passed the bill by a margin of 22-17 at its July 24, 2013, meeting. The bill is pending consideration by the full House.

Board of Governors Nominations

The Senate returned the previously submitted Board of Governors nominations to the President on January 3, 2014, because no action was taken during the First Session of the 113th Congress, which ended on December 31, 2013. These nominations failed confirmation during the First Session under the provisions of Rule XXXI, paragraph 6, of the Standing Rules of the Senate.

On January 6, 2014, President Obama resubmitted the following nominations to the Senate for consideration during the Second Session of the 113th Congress:

Stephen Crawford, of Maryland, to serve on the Board of Governors of the United States Postal Service for the remainder of the term expiring December 8, 2015.

David Michael Bennett, of North Carolina, to serve on the Board of Governors of the United States Postal Service for a term expiring December 8, 2018.

James C. Miller III, of Virginia, to serve on the Board of Governors of the United States Postal Service for the term expiring December 8, 2017.

Postal Regulatory Commission

The Senate returned the previously submitted PRC commissioner nominations to the President on January 3, 2014, because no action was taken during the First Session of the 113th Congress, which ended on December 31, 2013. These nominations failed confirmation during the First Session under the provisions of Rule XXXI, paragraph 6, of the Standing Rules of the Senate.

On January 7, 2014, the PRC announced the designation of Commissioner Mark Acton as Vice Chairman of the PRC. PRC regulations provide that the Commissioners elect a member to serve as Vice Chairman for a term of one year.

On January 6, 2014, President Obama resubmitted the following nominations to the Senate for consideration during the Second Session of the 113th Congress:

Nanci E. Langley, of Hawaii, to be Commissioner of the Postal Regulatory Commission for a term expiring November 22, 2018.

Tony Hammond, of Missouri, to be a Commissioner of the Postal Regulatory Commission for a term expiring October 14, 2018.

Item 3 – Quantitative and Qualitative Disclosures about Market Risk

In the normal course of business we are exposed to market risks from changes in commodity prices, certain foreign currency exchange rate fluctuations and interest rates. Our commodity price risk consists primarily of exposure to changes in prices for diesel fuel, unleaded gasoline and aircraft fuel for transportation of the mail, and fuel for heating facilities. We have foreign currency risk related to the settlement of terminal dues and transit fees with foreign postal administrations for international mail.

We have not used derivative commodity or financial instruments to manage market risk related to commodities, foreign currency exchange or interest rate fluctuations for debt instruments. Additionally, we do not purchase or hold derivative financial instruments for speculative purposes.

See our 2013 Annual Report on Form 10-K, Financial Section Part II, Item 7A-*Quantitative and Qualitative Disclosures about Market Risk.*

Item 4 – Controls and Procedures

Management is responsible for the preparation, integrity and fair presentation of the financial statements of the Postal Service.

Disclosure Controls
We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in quarterly and annual reports is recorded, processed, summarized, and reported within the time frames specified by P.L. 109-435, and that this information is accumulated and communicated to our management, including the Postmaster General and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

We carried out an evaluation under the supervision and with the participation of management, including the Postmaster General and Chief Financial Officer, of the effectiveness of the design and operation of disclosure controls and procedures as of December 31, 2013. Based upon, and as of the date of, the evaluation, the Postmaster General and Chief Financial Officer concluded that our disclosure controls and procedures were effective.

Internal Controls
There have been no changes in the Postal Service's internal controls over financial reporting during the quarter ended December 31, 2013, that have materially affected, or are reasonably likely to materially affect, the Postal Service's internal control over financial reporting.

Part II. OTHER INFORMATION

Item 1 – Legal Proceedings

For a discussion of legal proceedings affecting us, please refer to our annual report Form 10-K, filed on November 15, 2013, as well as the information under the caption "*Legal Matters and Contingent Liabilities*" within *Item 2 - "Management's Discussion and Analysis of Financial Condition and Results of Operations"* included in this report.

Item 1A – Risk Factors

There have been no material changes in risk factors from those disclosed in Part I, Item 1A of our Annual Report on Form 10-K for the year ended September 30, 2013.

Item 4 – Mine Safety Disclosures

Not applicable.

Item 6 – Exhibits

Exhibit Number	Description of Exhibit
31.1	Certification of Principal Executive Officer Pursuant to Rules 13a-14(a) and 15d-14(a) under the Securities and Exchange Act of 1934, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Principal Financial Officer Pursuant to Rules 13a-14(a) and 15d-14(a) under the Securities and Exchange Act of 1934, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Principal Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Principal Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Signatures

Pursuant to the requirements of the Postal Accountability and Enhancement Act of 2006, the United States Postal Service has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

United States Postal Service

/s/Patrick R. Donahoe
Patrick R. Donahoe
Postmaster General and Chief Executive Officer

Date: February 7, 2014

/s/Joseph Corbett
Joseph Corbett
Chief Financial Officer and Executive Vice President

Date: February 7, 2014

Exhibit 31.1

CERTIFICATION PURSUANT TO
RULES 13a-14(a) AND 15d-14(a) UNDER THE SECURITIES AND EXCHANGE ACT OF 1934, AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002.

I, Patrick R. Donahoe, certify that:

1. I have reviewed this quarterly report on Form 10-Q of the United States Postal Service (Postal Service);
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Postal Service as of, and for, the periods presented in this report;
4. The Postal Service's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Postal Service and have:
    a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Postal Service, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
    b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
    c. Evaluated the effectiveness of the Postal Service's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
    d. Disclosed in this report any change in the Postal Service's internal control over financial reporting that occurred during the Postal Service's most recent fiscal quarter (the Postal Service's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Postal Service's internal control over financial reporting; and
5. The Postal Service's other certifying officer and I have disclosed based on our most recent evaluation of internal control over financial reporting, to the Postal Service's auditors and the audit committee of the Postal Service's Board of Governors (or persons performing the equivalent functions):
    a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Postal Service's ability to record, process, summarize and report financial information; and
    b. Any fraud, whether or not material, that involves management or other employees who have significant role in the Postal Service's internal control over financial reporting.

Date: February 7, 2014

/s/Patrick R. Donahoe
Patrick R. Donahoe
Postmaster General and Chief Executive Officer

Exhibit 31.2

CERTIFICATION PURSUANT TO
RULES 13a-14(a) AND 15d-14(a) UNDER THE SECURITIES AND EXCHANGE ACT OF 1934, AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002.

I, Joseph Corbett, certify that:

1. I have reviewed this quarterly report on Form 10-Q of the United States Postal Service (Postal Service);

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Postal Service as of, and for, the periods presented in this report;

4. The Postal Service's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Postal Service and have:

   a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Postal Service, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c. Evaluated the effectiveness of the Postal Service's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d. Disclosed in this report any change in the Postal Service's internal control over financial reporting that occurred during the Postal Service's most recent fiscal quarter (the Postal Service's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Postal Service's internal control over financial reporting; and

5. The Postal Service's other certifying officer and I have disclosed based on our most recent evaluation of internal control over financial reporting, to the Postal Service's auditors and the audit committee of the Postal Service's Board of Governors (or persons performing the equivalent functions):

   a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Postal Service's ability to record, process, summarize and report financial information; and

   b. Any fraud, whether or not material, that involves management or other employees who have significant role in the Postal Service's internal control over financial reporting.

Date: February 7, 2014

/s/Joseph Corbett
Joseph Corbett
Chief Financial Officer and Executive Vice President

Exhibit 32.1

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002.

In connection with the Quarterly Report of the United States Postal Service (Postal Service) on Form 10-Q for the period ended December 31, 2013, (the Report), I, Patrick R. Donahoe, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Postal Service.

Dated: February 7, 2014

/s/Patrick R. Donahoe
Patrick R. Donahoe
Postmaster General and Chief Executive Officer

Exhibit 32.2

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002.

In connection with the Quarterly Report of the United States Postal Service (Postal Service) on Form 10-Q for the period ended December 31, 2013 (the Report),I, Joseph Corbett, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Postal Service.

Dated: February 7, 2014

/s/Joseph Corbett
Joseph Corbett
Chief Financial Officer and Executive Vice President